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Investing in rural people

Report on IFAD's Investment Portfolio for 2019

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For: **Information**

Executive summary

1. The value of the investment portfolio in United States dollar terms decreased by US\$32.9 million, from US\$1,036.7 million at 31 December 2018 to US\$1,003.9 million at 31 December 2019.¹ The main factors for the decline were outflows of US\$42.0 million and negative foreign exchange movements of US\$14.1 million, while positive income was US\$23.2 million.
2. Returns were stable throughout the year as the asset allocation of the portfolio took a conservative stance. Nonetheless, returns exceeded those of 2018. The portfolios benefited from a decline in interest rates globally and stable credit spreads.
3. The portfolio risk levels decreased during the year:
 - Portfolio duration levels decreased from 1.21 years to 0.50 years.
 - The conditional value at risk (CVaR) of the overall portfolio decreased from 1.03 per cent to 0.81 per cent.
 - Exposure to BBB-rated debt was 0 per cent of the portfolio at the end of 2019 compared to 2.5 per cent at the end of 2018.
4. The overall size of the portfolio exceeds the minimum liquidity requirement (see section E).

Table 1
Key portfolio changes during 2019

	2018	2019
Portfolio size (thousands of US\$)	1 036 729	1 003 862
Net investment income (thousands of US\$)	506	23 243
Rate of return (percentage)	0.09	2.13
Duration (years)	1.21	0.50
CVaR (percentage)	1.03	0.81

¹ Figures in this report have been rounded up or down. There may therefore be discrepancies between the actual totals of the individual amounts in the tables and the totals shown, as well as between the numbers in the tables and the numbers included in the corresponding analyses in the text of the annual report. All roundings, totals, percentage changes and key figures were calculated using the complete (unrounded) underlying data.

Report on IFAD's Investment Portfolio for 2019

I. Market conditions

1. United States treasury yields declined significantly in 2019 as the Federal Reserve (Fed) turned to an easing cycle and United States-China trade tensions escalated. However, in the fourth quarter, easing trade tensions and a signal by the Fed to pause its expansionary monetary policy cycle caused rates to partially retrace. In Europe, rates continued in negative territory with the focus shifting away from monetary policy to potential fiscal expansion.
2. Against this backdrop, risk assets performed strongly; consequently credit spreads remained tight, as loose monetary policy in the United States and Europe continued to ensure that investor risk appetite remains.

Table 1

Movements affecting IFAD's asset allocation within the portfolio in 2019

(Thousands of United States dollars equivalent)

	Operational cash ^a	Global strategic portfolio	Global liquidity portfolio	Global credit portfolio	Asset liability portfolio	Other	Total
Opening balance (1 Jan 2019)	45 150	143 990	219 575	150 671	476 680	663	1 036 729
Net investment income	1 459	2 520	7 779	5 281	6 213	(9)	23 243
Net flows ^b	91 856	(146 214)	96 921	(154 769)	70 329	(108)	(41 985)
Foreign exchange movements	(3 165)	(295)	40	(1 183)	(9 113)	(409)	(14 126)
Closing balance (31 Dec 2019)	135 300	-	324 314	-	544 109	138	1 003 862

^a Cash held with banks, readily available for disbursing loans, grants and administrative expenses.

^b Net flows consist of outflows in respect of loan and grant disbursements and administrative expenses, and inflows from loan reflows and encashment of Member State contributions.

II. Investment income

3. Gross investment income in 2019 amounted to US\$24.1 million, while net investment income inclusive of all investment-related fees (totalling US\$0.8 million) amounted to US\$23.2 million. Table 2 presents a summary of 2019 investment income broken down by portfolio.

Table 2
Breakdown of IFAD's investment income by asset class in 2019
(Thousands of United States dollars equivalent)

Investment income	Operational cash	Global Strategic Portfolio	Global Liquidity Portfolio	Global Credit Portfolio	Asset Liability Portfolio	Other	Total
Interest and coupon income	1 571	1 872	6 288	1 632	1 568	-	12 930
Realized market gains/(losses)	21	675	1 342	1 690	(1 126)	-	2 602
Unrealized market gains/(losses)	-	-	321	2 146	6 040	-	8 507
Amortization*	-	51	-	-	-	-	51
Investment income before fees	1 592	2 598	7 950	5 468	6 482	0	24 090
Investment manager fees	-	-	-	(105)	-	7	(98)
Custody fees	(3)	(22)	(51)	(30)	(54)	(15)	(176)
Bank charges	(129)	-	-	-	(1)	-	(130)
Advisory and other investment-related fees	-	(56)	(120)	(53)	(214)	-	(443)
Investment income after fees	1 459	2 520	7 779	5 281	6 213	(9)	23 243

*Amortization represents a portion of the difference between purchase price and final redemption value for the global strategic portfolio, reported at amortized cost.

III. Rate of return

4. The rate of return on IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements.
5. Excluding the Asset Liability Portfolio (ALP), IFAD's investment portfolio generated a net return of 3.03 per cent for 2019, outperforming the benchmark by 0.64 per cent. The ALP generated a positive gross return of 1.22 per cent, exceeding the portfolio's cost of funding (0.17 per cent).

Table 3
Quarterly gross performance together with annual performance versus benchmarks in 2019
(Percentages in local currency terms)

	2019 quarterly and annual performance and benchmarks						
	First quarter	Second quarter	Third quarter	Fourth quarter	Annual 2019	Benchmark 2019	Difference
Operational cash	0.40	0.44	0.12	0.34	1.31	1.31	0.00
Global Strategic Portfolio ^a	0.59	0.61	0.72	n.a.	1.93	0.62	1.31
Global Liquidity Portfolio	0.71	0.77	0.99	0.37	2.73	1.11	1.62
Global Credit Portfolio ^b	2.98	0.65	n.a.	n.a.	3.65	4.72	(1.07)
Gross rate of return excluding ALP	1.28	0.68	0.77	0.36	3.13	2.39	0.74
Net rate of return excluding ALP	1.24	0.65	0.75	0.35	3.03	2.39	0.64
Asset liability portfolio ^c	0.77	0.36	0.11	0.02	1.22	0.17	1.05
Gross rate of return including ALP	1.05	0.52	0.45	0.18	2.22	n.a.	n.a.
Net rate of return including ALP	1.02	0.50	0.44	0.17	2.13	n.a.	n.a.

^a The Global Strategic Portfolio was closed on 31 July 2019.

^b The Global Credit Portfolio was closed on 30 June 2019.

^c The ALP benchmark is a target rate of return representing the cost of funding. It does not reflect the investment universe allowed by the guidelines.

Table 4
IFAD portfolio performance rolling average as at 31 December 2019
(Percentages in local currency terms)

	<i>One year</i>	<i>Three years</i>	<i>Five years</i>
Portfolio performance	2.13	1.46	1.44

6. For comparative purposes, table 5 presents annual portfolio performance over the previous four years.

Table 5
Historical annual performance versus benchmarks
(Percentages in local currency terms)

	<i>2018</i>		<i>2017</i>		<i>2016</i>		<i>2015</i>	
	<i>Actual</i>	<i>Benchmark</i>	<i>Actual</i>	<i>Benchmark</i>	<i>Actual</i>	<i>Benchmark</i>	<i>Actual</i>	<i>Benchmark</i>
Operational cash	0.88	0.88	0.79	0.79	0.30	0.30	0.13	0.13
Global Strategic Portfolio	2.22	1.02	1.92	0.80	1.83	0.95	1.75	1.12
Global Liquidity Portfolio	2.16	0.00	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Asset Liability Portfolio	(0.91)	0.21	0.96	0.22	0.62	0.00	0.12	0.30
Chinese Renminbi Portfolio	1.46	0.0	3.72	0.00	0.48	0.00	n.a.	n.a.
Global Government Bonds	0.89	1.88	0.27	0.99	0.64	1.03	0.05	0.43
Global Credit Portfolio	0.00	0.90	3.43	3.31	3.23	3.52	1.17	1.25
Global Inflation-indexed Bonds	0.16	0.39	1.86	1.53	4.41	4.37	(0.85)	(0.51)
Emerging Market Debt Bonds	(3.07)	(2.55)	8.45	7.64	6.83	6.40	(1.17)	(0.86)
Gross rate of return (excluding fees)	0.21	n.a.	2.35	n.a.	3.09	n.a.	0.13	0.35
Net rate of return (including all fees)	0.09	n.a.	2.21	n.a.	2.91	n.a.	(0.06)	0.16

IV. Composition of the portfolio by instrument

7. Table 6a shows the composition of the investment portfolio by instrument as at 31 December 2019.

Table 6a
Investment portfolio by instrument as at 31 December 2019

<i>Instrument</i>	<i>Actual portfolio allocation</i>	
	<i>Millions of United States dollars</i>	<i>Percentage</i>
Cash	164.9	16.4
Swaps	(1.8)	(0.2)
Time deposit	0.0	0.0
Global government bonds	460.7	45.9
Global credit bonds	380.0	37.9
Total	1 003.9	100.0

8. In December 2018, to align the Fund with other international financial institutions (IFIs), IFAD moved from a strategic asset allocation to a tranching approach for risk budgeting and asset allocation. This means that the portfolio is invested in different layers based on the liquidity needs of the institution rather than setting specific limits for each asset class. Consequently, the IFAD investment portfolio was split into four tranches, as follows:

- **Liquidity tranche:** Used for immediate cash disbursements;

- **Buffer tranche:** Should the liquidity tranche be temporarily depleted due to an unforeseen spike in disbursements, funds in the buffer tranche will be used to fund outflows. The size of the tranche is determined by the parameters of IFAD's minimum liquidity requirement (MLR);
 - **Surplus tranche:** These are funds in addition to what is required for the MLR and are used to provide enhanced returns; and
 - **Funding tranche:** Borrowed funds, managed according to an asset and liability management framework.
9. Table 6b shows the net asset value of the portfolio based on the new tranching approach.

Table 6b
2019 portfolio by tranche

<i>Tranche</i>	<i>%</i>	<i>US\$ millions</i>
Liquidity	13.5	135.3
Buffer	32.4	324.9
Surplus	-	-
Funding	54.2	544.1
Hedge *	(0.0)	-5
Total	100.0	1 003.9

* The hedge portfolio is shown separately as its derivative positions are established to immunize the entire portfolio against interest rate risk and foreign exchange rate risk.

V. Risk measurements

10. The risk budgeting measures outlined in IFAD's Investment Policy Statement (IPS) – duration and CVaR – are reported on in subsections A and B below. Other risk indicators are reported in subsections C and D.

A. Market risk: Duration

11. Duration is a measure of the sensitivity of the market price of a fixed-income investment to a change in interest rates (expressed as a number of years). In general, a portfolio of securities with a lower duration can be expected to be less sensitive to interest rate changes than a portfolio with a higher duration.

Table 7
Effective duration of IFAD's investment portfolio and benchmarks
(Duration in number of years)

	<i>31 December 2019</i>		<i>31 December 2018</i>	
	<i>Portfolio</i>	<i>Benchmark</i>	<i>Portfolio</i>	<i>Benchmark</i>
Asset Liability Portfolio	0.8	0.5	0.7	0.0
Global Liquidity Portfolio	0.3	0.5	0.3	0.0
Global Credit Portfolio	n.a.	n.a.	4.7	4.6
Total portfolio (including global strategic portfolio and operational cash)	0.5	0.4	1.2	1.2

Note: The total portfolio duration is lowered because the operational cash portfolio is not subject to interest rate fluctuations.

The overall portfolio duration was 0.50 years (1.21 years in 2018), which is indicative of the investment portfolio risk reduction.

B. Market risk: Conditional value at risk

12. The CVaR is a measure of the possible percentage losses to a portfolio under extreme market conditions. The investment portfolio CVaR is stated with a 95 per cent confidence level over a forward-looking one-year horizon.
13. The maximum risk level for the IFAD portfolio is stated in the IPS as a CVaR of 3.0 per cent. In 2019 the CVaR for the overall portfolio was 0.81 per cent, which is

well below the approved IPS risk level and lower than in 2018. The current CVaR risk level of 0.81 per cent means that the loss to the overall portfolio under extreme market conditions could be US\$8.2 million.

Table 8

CVaR of IFAD's asset classes at 31 December 2019 and 2018

(95 per cent confidence level; percentages based on historical simulations over five-year history)

	<i>Actual investment portfolio one-year CVaR</i>	
	<i>31 December 2019</i>	<i>31 December 2018</i>
Asset liability portfolio	1.15	1.34
Global liquidity portfolio	1.17	0.64
Global credit bonds	n.a.	3.51
Total portfolio^a (including global strategic portfolio and cash)	0.81	1.03

^a Portfolio CVaR is lowered by the operational cash component of the portfolio, which has a CVaR equal to zero.

C. Credit risk: Credit rating analysis

14. IFAD's IPS establishes a credit rating floor. Credit risk is also managed by monitoring securities in accordance with investment guidelines, which may provide for stricter credit quality requirements than those contained in the IPS.

Table 9

Investment portfolio compositions by credit ratings at 31 December 2019

(Thousands of United States dollars equivalent)

	<i>Operational Cash</i>	<i>Global Liquidity Portfolio</i>	<i>Asset Liability Portfolio</i>	<i>Other</i>	<i>Total</i>	<i>Percentage</i>
AAA	-	248 197	11 247	-	259 444	25.8
AA+/-	-	73 345	185 358	-	258 703	25.8
A+/-	-	-	322 604	-	322 604	32.1
Cash ^a	135 300	2 581	26 874	138	164 893	16.4
Time deposit	-	-	-	-	-	0.0
Pending trades ^b	-	-	-	-	-	0.0
Swaps	-	192	-1 976	-	-1 783	(0.2)
Total 2019	135 300	324 314	544 109	138	1 003 862	100.0
Total 2018	45 150	219 575	476 680	4	1 036 729	100.0

^a Consists of cash and equivalents with central banks and approved commercial banks and cash held by external portfolio managers. These amounts are not rated by credit rating agencies.

^b Pending foreign exchange purchases and sales used for hedging purposes and trades pending settlement. These amounts do not have an applicable credit rating.

D. Currency risk: Currency composition analysis

15. In order to protect the short-term liquidity profile from foreign currency risk fluctuations, IFAD ensures that the currency composition of projected inflows matches that of outflows over a 24-month horizon. Negative mismatches (deficits of liquidity) of any currency above 10 per cent of total outflows require the establishment of hedging positions that will reduce foreign exchange exposure below the 10 per cent threshold.

Table 10
Currency composition of assets and commitments as at 31/12/2019
(Thousands of United States dollars equivalent)

Category	CNY Group	EUR Group	GBP Group	JPY Group	USD Group	Grand Total
Current Liquidity						
Cash	100	38 525	2 234	113	93 282	134 254
Investments	591	53	4	0	324 566	325 213
Projected Inflows						
Contributions	39 409	186 336	84 684	28 286	201 351	540 065
Projected Reflows	82 622	247 582	63 989	61 878	348 814	804 885
Debt Drawdowns	0	0	0	0	126 707	126 707
Projected Liquidity	122 721	472 497	150 911	90 277	1 094 719	1 931 124
Projected Outflows						
Projected disbursements	(82 925)	(306 629)	(64 223)	(62 105)	(1 026 156)	(1 542 039)
Projected operating expenses	0	(226 098)	0	0	(144 555)	(370 653)
Debt repayments and interest	0	(112)	0	0	(200)	(312)
Projected Outflows Total	(82 925)	(532 839)	(64 223)	(62 105)	(1 170 911)	(1 913 004)
Hedging						
Currency forwards	0	0	(80 538)	(19 924)	100 000	(463)
Hedging Total	0	0	(80 538)	(19 924)	100 000	(463)
Projected liquidity (deficit)/excess	39 796	(60 343)	6 149	8 247	23 808	23 120
(Deficit)/Excess as percentage of commitments	2.08%	(3.15%)	.32%	.43%	1.24%	0.95%

* The difference in the cash and investments balance compared with other tables is derived mostly from the exclusion of the ALP (US\$544 million equivalent). The ALP is not subject to the currency alignment since, in line with commitments, it is maintained in euros.

E. Liquidity risk: Minimum liquidity requirement

16. IFAD's latest financial model results – incorporating the resources available for commitment in 2019 under the sustainable cash flow approach – calculate an MLR of US\$621.0 million (60 per cent of gross annual outflows),² which is comfortably cleared by IFAD's investment portfolio balance of US\$1,003.9 million (see table 1).

² Corporate Risk Dashboard, fourth quarter 2019.